

STATE OF NORTH CAROLINA  
COUNTY OF WAKE

BEFORE THE  
SECRETARY OF REVENUE

IN THE MATTER OF:

The Proposed Denial of Individual Income )  
Tax Refunds for the Taxable Years )  
1992, 1993, 1994, 1995, 1996, and 1997 )  
by the Secretary of Revenue of North Carolina )  
vs. )  
[Taxpayers] )

**FINAL DECISION**  
Docket No. 2000-524

This matter was heard by the Assistant Secretary of Administrative Hearings, Eugene J. Cella, upon a timely application for hearing by [Taxpayers, Husband and Wife], wherein they protested the denial of refunds of individual income tax for the tax years 1992 through 1997. At Taxpayers' request, the hearing was conducted via written communication and the decision is based on all information presented for the record as of March 5, 2001. The hearing was held by the Assistant Secretary under the provisions of G.S. 105-260.1.

Although Taxpayers were nonresidents of North Carolina during the tax years 1992, 1993, 1994, 1995, 1996, and 1997 and were not required to file North Carolina income tax returns, they timely filed returns for those years. On each return, Taxpayers calculated North Carolina taxable income by including retirement benefits paid by the Teachers and State Employees Retirement System of North Carolina.

Wife retired from the State of North Carolina and is eligible for a refund of the taxes she paid on her government retirement benefits in the tax years 1989 through 1997 under the terms of the *Bailey* settlement, as evidenced by the *Referee's Report* dated April 6, 2000 (Exhibit PT-14). Taxpayers agreed on the refunds computed by the Settlement Administration Organization (SAO) for the tax years 1989, 1990, and 1991. The refunds for the tax years 1992 through 1997 are in dispute. The SAO contends that because Wife was not required to file North Carolina returns for tax years 1992 through 1997, her payments were voluntary and not illegally paid. The referee instructed the SAO not to make refunds to Wife for tax years 1992 through 1997. Consequently, Taxpayers filed amended North Carolina income tax returns with the Department of Revenue for the tax years 1992, 1993, 1994, 1995, 1996, and 1997, reducing North Carolina taxable income by the State retirement benefits included on the original returns. Upon examination, the Department denied Taxpayers' claims for refund because the claims arose from the taxation of State, local, or federal government retirement benefits. Under the terms of the settlement reached in the combined cases of *Bailey v. State of North Carolina*, *Emory v. State of North Carolina*, and *Patton v. State of North Carolina*, the \$799 million paid by the State completely extinguished the State's liability to all State, local, and federal retirees arising from the taxation of State, local, and federal retirement benefits from 1989 through 1997.

## **ISSUE**

The issue to be decided in this matter is as follows:

Is the denial of the refunds requested for the taxable years 1992, 1993, 1994, 1995, 1996, and 1997 lawful and proper?

## **EVIDENCE**

The evidence presented by the Personal Taxes Division of the Department of Revenue consisted of Exhibits PT-1 through PT-21. Taxpayers did not present any further legal arguments or additional evidence in support of their objection to the denial of refunds.

## **DECISION**

The terms of the proposed settlement in *Bailey* were set forth in a *Consent Order* signed by Judge Thompson of the Wake County Superior Court on June 10, 1998. Provision 3 of the *Consent Order* states that “it is the intent of the parties that the sum paid under the settlement will completely extinguish all of the State’s liability to all State, local and federal retirees arising from the taxation of State, local and federal retirement income and benefits from 1989 through 1997. To this end, the parties recognize that Class Members must be given an opportunity to “opt out” of these class actions.” In an *Order Approving Class Action Settlement* filed October 9, 1998, Judge Thompson concluded that “the settlement set forth in the June 10, 1998, Consent Order is fair, adequate, and reasonable and in the best interest of the Class and is hereby approved.” As Wife elected not to opt out of the Consent Order, she became bound by all of its terms. Consequently, any liability of the State for the tax paid by Wife on her retirement benefits for the years at issue was extinguished under the *Bailey* settlement.

In an *Order Approving Plan of Settlement Administration* signed on November 25, 1998, Judge Thompson approved a *Plan of Settlement Administration* proposed by Class Counsel. Part 1E of the section of the Plan titled *Allocation of Settlement Fund* addresses the calculation of overpayments and related interest. The overpayment amount for each year is the lesser of (a) the class member’s tax paid for that year or (b) an amount calculated by multiplying the

Class Member's effective tax rate by the Class Member's retirement benefits received less the Class Member's Retirement Benefits Deduction for that year.

Under the terms of the *Plan of Settlement Administration*, Wife's overpayment for the years at issue should be calculated by the SAO notwithstanding the fact that she was not required to file North Carolina returns for those years. Wife paid the tax; she is entitled to a refund from the SAO as ordered in the Allocation of Settlement Fund. The Secretary of Revenue does not supervise and is not responsible for the manner in which Class Counsel administers the Plan of Settlement Administration. Furthermore, he is not authorized to supplement sums paid under the plan by amounts that class members contend should have been allowed and paid as refunds.

Therefore, it is the decision of the Assistant Secretary of Administrative Hearings that the denial of the income tax refunds requested by Taxpayers was lawful and proper and is hereby sustained.

Made and entered this 5<sup>th</sup> day of June, 2001.

Signature\_\_\_\_\_

Eugene J. Cella  
Assistant Secretary of Administrative Hearings